MONTANA LEGISLATIVE BRANCH

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DATE: March 8, 2000

TO: Legislative Finance Committee

FROM: Terry W. Johnson
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RE: General Fund Briefing Summary

INTRODUCTION

The purpose of this report is to provide the Legislative Finance Committee (LFD) with a brief summary of the financial status of the state general fund account. Since the Montana Supreme Court decision on HB 260 (Coal Producers' License Tax) was issued in January 2000, several legislators and the media have inquired about the general fund balance and the outlook for the account by the end of the current biennium.

There also has been considerable discussion over "what is the balance" in the general fund account. Terms such as "surplus", "excess", and "ending balance" have been used interchangeably without regard to the projected ending balance planned or budgeted by the 56th Legislature.

This report summarizes the final fiscal 1999 ending fund balance data for the general fund account and highlights why the balance was higher than anticipated. This document also discusses the potential general fund balance by the end of the 2001 biennium based on potential supplemental appropriations and a preliminary analysis of individual income tax returns for tax year 1998. Since our office received this data on February 29, we have not had sufficient time to complete a full analysis of this information.

FISCAL 1999 FUND BALANCE DISCUSSION

The general fund account balance at the beginning of fiscal 1999 was $44.3 million. Based on House Joint Resolution 2 (HJR 2) revenue estimates and disbursement budgets adopted during the 55th and 56th legislative sessions, this balance was forecast to increase to $72.0 million by the end of fiscal 1999[1]. Total revenues (including one-time transfers) were expected to exceed total expenditures by approximately $24.7 million.

[1] See Legislative Fiscal Report, 2001 Biennium Overview June 1999, page 8.

As shown in Table 1, the final general fund unreserved, undesignated balance for fiscal 1999 was $109.7 million, or $37.7 million above the level anticipated by the 56th Legislature. Table 1 also shows the differences between budgeted and actual amounts for revenues, disbursements, and other adjustments.

Table 1
General Fund Account
Fiscal 1999 Budgeted Versus Actual
Fund Balance Detail

	Budgeted Amount [1]	Actual FYE 1999	Over (Under) Estimate	Diff. Percent
Beginning GAAP Balance	$44,309,000	$44,308,699	(301)	0.00%
General Fund Receipts	1,068,111,000	1,069,981,501	1,870,501	0.18%
Prior Year Rev. Adjustments	0	20,897,909	20,897,909	NA
Residual Equity Transfers	2,951,000	60	(2,950,940)	-100.00%
Total Revenue	$1,071,062,000	$1,090,879,470	$19,817,470	1.85%
General Fund Disbursements	1,043,418,000	1,037,930,918	(5,487,082)	-0.53%
Non-Budgeted Disbursements	0	(29,667)	(29,667)	NA
Prior Year Exp. Adjustments	0	891,342	891,342	NA
Total Disbursements	$1,043,418,000	$1,038,792,593	($4,625,407)	-0.44%
Other Fund Balance Adjustments	0	13,278,287	13,278,287	NA
Total Adjustments	0	13,278,287	13,278,287	NA
Unreserved, Undesignated Balance	$71,953,000	$109,673,863	$37,720,863	52.42%

1 Legislative Fiscal Report, 2001 Biennium Overview, June 1999

Table 2 shows the reasons and the associated dollar impact for the "excess" general fund balance observed during fiscal 1999. The term "excess" is used because the 56th Legislature developed the 2001 biennium budget based on an anticipated ending fund balance of $72.0 million. This higher than usual balance was adopted because the legislature assumed the tax relief measures adopted for the 2001 biennium would reduce this balance in the subsequent biennium. As shown in Table 2, fiscal 1999 revenue collections exceeded the legislative

Table 2
Reasons for General Fund Balance Excess
In Millions

Explanation of Fund Balance Excess	Fiscal 1999
Beginning Balance	$0.0
Revenue Collections (Actual - Estimated)	19.8
Disbursements (Budgeted - Actual)	4.6
Fund Balance Adjustments	13.3
Total Excess	$37.7

estimate by $19.8 million, disbursements were $4.6 million lower than authorized (higher reversions), and fund balance adjustments of $13.3 million were not anticipated by the legislature.

After the unreserved, undesignated general fund balance was determined, our office received a number of inquires about the makeup and magnitude of the unexpected fiscal 1999 excess. Table 3 shows the total unexpected excess and whether the components contributing to the additional balance could be considered one-time or ongoing. As our fiscal analysis work proceeds this year, the one-time versus ongoing designation could change, depending on the results. Table 3 shows that of the $37.7 million in unexpected excess, approximately $23.7 million could be considered ongoing and $14.0 million should not occur again or is one-time.

Table 3
Fiscal 1999 Unexpected General Fund Excess
In Millions

Explanation of Fund Balance Excess	Ongoing	One-Time	Total
Revenue Collections	$19.8	$0.0	$19.8
Disbursements (Reversions)	0.0	4.6	4.6
Fund Balance Adjustments	3.9	9.4	13.3
Total Excess	$23.7	$14.0	$37.7

OUTLOOK FOR THE 2001 BIENNIUM

The 56th Legislature adjourned in April 1999 with a projected general fund ending fund balance for the 2001 biennium of $51.5 million. Per the general appropriations act (HB2), this balance includes $28.2 million of tobacco settlement funds that are "set aside for revenue stabilization in the general fund. This amount is classified as unreserved, designated general fund balance."

Based on our preliminary analysis of individual income tax returns for tax year 1998, other significant revenue trends, and anticipated supplemental requests, the projected ending fund balance for the 2001 biennium could be at least $86.3 million greater than budgeted by the legislature. The reasons for the potential improved fiscal condition are discussed below.

Individual Income Tax

Total general fund revenues were estimated to be $2,224.6 million for the 2001 biennium. Of this total, individual income taxes (43.7%), property taxes (16.7%), corporation income taxes (7.2%), and investment earnings (8.8%) comprise over 76 percent of the total revenue flow to the general fund account. Although all other sources contribute almost 24 percent of the total collections, the variability in their collection patterns should not affect total receipts materially.

Unlike most other general fund sources, individual income tax collections have exceeded projections by significant amounts. For example, in fiscal 1999 total collections were $38.9 million or 8.8 percent above the fiscal 1998 level. Until the waning days of the legislative session, the 56th Legislature expected individual income tax revenues to increase by only $13.5 million from fiscal 1998 to 1999. However, before adjournment, the senate increased the estimate by an additional $15.0 million for fiscal 1999 only. This adjustment was based on year to-date trends that indicated collections would exceed estimated levels.

Based on tax return data for calendar year 1998, our preliminary analysis indicates that taxpayer wage/salary and capital gains income was approximately $401.3 million above projected amounts contained in HJR 2 (Revenue Estimate Resolution). Table 4 shows the reported income amounts for these categories along with estimated and actual growth rates. The unusual growth rate in these two income categories explains the majority of the revenue increase from fiscal 1998 to 1999. The robust equity markets and higher employment levels elucidate why reported incomes in these categories increased beyond expectations.

Table 4
Tax Year 1998 Full-Year Residents
In Millions

Income Component	Estimated TY 1998	Actual TY 1998	Difference	Estimated Grow Rate	Actual Grow Rate
Wage & Salary	$7,570.719	$7,730.368	$159.649	4.3%	6.5%
Capital Gains or Losses	818.544	1060.174	241.63	0.0%	29.5%
Totals	$8,389.263	$8,790.542	$401.279		

This new data poses the question of whether these trends will continue, slow down, or decline in subsequent years. Any change in these growth rates could significantly influence the fiscal condition of the general fund account by the end of the 2001 biennium and beyond.

Using fiscal 1999 collections as the base and the growth rates delineated in HJR 2 for subsequent years, individual income tax collections could be about $53.8 million above the estimates adopted by the legislature for the 2001 biennium. It should be noted, however, that if wage/salary and capital gains income continue to increase in subsequent years at the amounts shown in Table 4, then individual income tax revenues could be significantly higher.

Corporation Income Tax

The corporation income tax revenue estimate adopted by the 56th Legislature for fiscal 2000 included $30.0 million of capital gains tax revenue from the sale of electrical generation assets owned by Montana Power Company (MPC), Puget Power and Light, and Portland General

Power and Light[2]. According to Mr. Kindt of MPC, the interests held by the companies other than MPC were not sold to Pennsylvania Power and Light, and it is uncertain whether they will be sold.[3] In addition, MPC did not sell its interest in Colstrip unit 4. MPC has estimated the sale of the generation assets increased their state tax liability by $21.1 million for fiscal 2000.

However, Mr. Kindt also apprised the Revenue and Taxation Committee that a buyout of three major qualifying contracts that MPC signed many years ago with Billings Generation, Montana One-Colstrip, and the state of Montana (Toston Dam) is pending. The buyout of these contracts by MPC is currently under negotiation and may cost as much as $400 million. According to Mr. Kindt, this would result in a tax deduction for MPC in the year the buyouts occur, and the state revenue loss could be about $16 million.

The state could recoup some of this revenue, however, if the companies with qualifying contracts incur increased Montana tax liability. Since the Toston dam is a state facility, monies from the buyout of this contract would be deposited into a debt service account and not to the general fund. Hopefully, more information on these negotiations will be known by this fall.

Oil Tax and Metalliferous Mines Tax

Other sources of revenue that our office is currently analyzing include oil taxes and metalliferous mines taxes. The economic assumptions that these estimates were based on have changed significantly since the adjournment of the legislature and have the potential of increasing total general fund revenues for the 2001 biennium.

Oil prices have increased dramatically in the last several months with the prospect of even higher prices in the near future. If the recent prices of $30 per barrel continue throughout the current biennium, general fund revenues could be higher than anticipated by the legislature. The higher prices are a direct result of self-imposed production quotas of OPEC and other major oil producing countries.

Palladium prices have ballooned to almost $1,000 per ounce and are currently around $660 per ounce. Since the legislature assumed an average price of $225 per ounce, total general fund revenues from the metalliferous mines tax could be more than anticipated.

In the mid-1990's, car makers agreed to adopt tighter national emission standards and chose to use palladium rather platinum in catalytic converters. Specialists in the industry realized that the switch to palladium would eventually increase demand beyond production levels. Furthermore, the current political uncertainty in Russia plus its ability to delay deliveries of palladium has created chaos in the market. Both Russia and South Africa are major producers of the metal.

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2 Portland General owns 20% of units 3 & 4; Puget Power owns 50% of units 1 & 2, and 25% of units 3 & 4; PacifiCorp owns 10% of units 3 & 4; and Avista owns 15% of units 3 & 4.

3 In February, the Oregon Public Utility Commission denied permission to Portland General to sell their interests in the Montana properties. Also, the Washington Public Utility Commission recently approved the sale of Puget's interest in the Montana properties, but Puget's Board disagrees with the Commission's terms.

Supplemental Appropriations

According to the executive budget office, supplemental appropriations for the 2001 biennium will be about $4.0 million. This estimate is based on anticipated fire suppression costs for the Department of Natural Resources and Conservation.

In addition to this estimate, our office has examined the costs of K-12 public school support. Based on our analysis, the Superintendent of Public Instruction will need a supplemental appropriation of approximately $1.2 million. Most of this additional cost is for guaranteed tax base costs.

SUMMARY

Table 5 summarizes the fiscal categories that could potentially produce an excess in the general fund account by the end of the 2001 biennium. If the revenue and expenditure trends as portrayed above continue throughout the current biennium, the general fund account could have a potential ending fund balance of $137.8 million, which is $86.3 million above the level budgeted by the 56th Legislature.

Table 5
General Fund Account
Potential Excess & Ending Balance
In Millions

Revenue/Disbursement	Estimated 2001 Biennium
Fiscal 1999 Excess Balance	$37.7
Potential Additions	
Individual Income Tax	53.8
Potential Deductions	
Supplemental Appropriations	(5.2)
Total Potential Excess	$86.3
Budgeted Balance 56th Legislature	51.5
Potential Ending Fund Balance	$137.8

This estimate should be viewed as conservative since the income tax estimates shown in Table 5 does not assume a continuation in wage/salary and capital gains income grow rates observed from calendar 1997 to 1998. Also not included in Table 5 is the potential additional revenue from oil and metalliferous mines taxes. This is because of the volatility occurring within the oil and palladium prices.

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